

MINUTES
REGULAR MEETING OF THE BOARD OF LAND COMMISSIONERS
Monday, July 26, 2004, at 9:00 a.m.
State Capitol Building, Room 303

PRESENT: Governor Judy Martz, Superintendent of Public Instruction Linda McCulloch, and Secretary of State Bob Brown

VIA TELEPHONE: State Auditor John Morrison and Attorney General Mike McGrath

Motion was made by Mr. Brown to approve the minutes of the Board of Land Commissioners' meeting held June 21, 2004. Seconded by Ms. McCulloch. Motion carried unanimously.

BUSINESS TO BE CONSIDERED

704-1 **DEPT OF MILITARY AFFAIRS – TRANSFER OF DILLON ARMORY**

This is a request for final approval of the transfer of the Dillon Armory which came before the Board in March 2003, and preliminary approval was granted at that time. Since then, the Department of Military Affairs and DNRC have assured compliance of the policy set forth for disposal of such properties. Mr. Clinch requested approval.

Motion was made by Ms. McCulloch to approve the transfer of the Dillon Armory. Seconded by Mr. Brown. Motion carried unanimously.

Mr. Clinch requested the Board address the three proposed timber sales collectively. All sales have gone through the public process, notices were sent to interested parties and published in newspapers. All responses have been mitigated into each sale. Each sale has been analyzed for historical or cultural sites and none were identified. In all three sales, no significant environmental impacts will result. Each sale has a specific volume delineated as well as a specific Forest Improvement Fee that will be assessed to do follow up work.

704-2 **YELLOW BAY #2 TIMBER SALE**

This proposed sale is located 15 miles northeast of Polson and proposes to harvest timber from 120 acres in one harvest unit. The volume is 11,824 tons of sawlogs which will generate approximately \$355,902. The purpose is to improve forest health and productivity of the stands by harvesting dead and dying timber infested with beetles. All roads are existing and will be improved and reconstructed. A temporary road use permit will be obtained from the Bureau of Indian Affairs. An additional Forest Improvement Fee of \$12.31/ton will be charged.

704-3 **SWAMP RIDGE TIMBER SALE**

This proposed sale is located four miles east of Plains and proposes to harvest timber from 449 acres in ten harvest units. The volume is 16,373 tons and will generate approximately \$448,620.20. The purpose is to treat a rapidly expanding insect and disease outbreak and to ensure productivity of this section in the

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future. Selective as well as regenerative harvest systems will be utilized. Approximately 2.8 miles of road construction and 6.5 miles of reconditioning is required to meet BMPs. Upon completion of the sale, all newly constructed roads will be closed and all disturbed soil will be grass seeded. An additional Forest Improvement Fee of \$11.92/ton will be charged.

704-4 ASHLEY LAKE TIMBER SALE

This proposed sale is located 13 miles west of Kalispell and involves the harvest of 628 acres in three harvest units. The volume is 38,412 tons which will generate approximately \$1,127,191.78. The purpose is to create a healthy and vigorous forest and to promote historic and biologically diverse stand conditions. Seed tree/shelterwood harvests will be used. Access is across existing roads. Approximately nine miles of road maintenance will be required to meet BMPs. Upon completion, all spur roads will be closed. A Forest Improvement Fee of \$10.66/ton will be charged.

Motion was made by Mr. Brown to approve the three timber sales, Yellow Bay, Swamp Ridge, and Ashley Lake. Seconded by Ms. McCulloch. Motion carried unanimously.

704-5 COMMUNITIZATION AGREEMENT
(J. Burns Brown Operating Company)

Communitization Agreements are agreements that bring smaller tracts together in conformity with spacing requirements set forth by the Board of Oil and Gas. This particular tract is in Hill County, the department has 50% of the communitization of 320 acres. It will share in 50% of the royalties. Mr. Clinch requested approval.

Motion was made by Ms. McCulloch to approve the communitization agreement. Seconded by Mr. Brown. Motion carried unanimously.

704-6 DISCLAIMER OF INTEREST – LUTZ

This request is from Bruce and Nellie Lutz relative to any interest the state may have in a piece of property near Essex, Montana. Department staff have reviewed the request and determined the state has no particular interest in this tract by virtue of the fact that the state relinquished ownership of Section 16 back to the federal government in 1913. Mr. Clinch recommended approval and the issuance of a Disclaimer of Interest to allow the Lutz' to pursue a quiet title action.

Motion was made by Mr. Brown to approve the request for a Disclaimer of Interest. Seconded by Ms. McCulloch. Motion carried unanimously.

704-7 RIGHTS-OF-WAY APPLICATIONS

Mr. Clinch said this month there are 35 rights-of-way applications. There are two corrections to the package, #12536 from the United States of America, Bureau of Land Management, and #12537 from Flathead School District #5 have inaccurate statements that their application is made pursuant to §77-1-130, MCA, Historic Rights-of-Way. Neither application falls under that statute. Also, #12537 lists the

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compensation as \$6,000 and it should be \$600,000. Mr. Clinch suggested the Board move the package of rights-of-ways with the exception of #12537, Flathead School District, which he wanted to discuss in more detail. The Board considered applications #12536 from the Bureau of Land Management for reciprocal public access road; #12538 through 12568 from Sun River Electric for electric distribution lines; #12569 from Sheridan Electric Co-op for an overhead electric distribution line; and #12570 from Northern Telephone Co-op for a telecommunication cable. Mr. Clinch requested approval.

Motion was made by Ms. McCulloch to approve the rights-of-way package, excluding the request from the Flathead School District #5, and with the changes noted on #12536. Seconded by Mr. Brown. Motion carried unanimously.

Rights-of-Way No. 12537 – Flathead School District #5

Mr. Clinch said this particular right-of-way pertains to a piece of property that we've had lengthy discussions on regarding the potential development of a new school facility in Flathead County.

Jeanne Holmgren, DNRC, said on this application, as mentioned by Mr. Clinch, the compensation is indicated as \$6,000, the compensation for this 60 acre easement should read \$600,000. The action before the Board today is to approve this easement with a five-year option agreement, \$6,000 annually for as long as the school district maintains that option agreement. The option agreement provides for the school district to receive approval from the voters for the location of a high school and for the bonding purposes of the high school.

Mr. Clinch said the \$6,000 is the appropriate amount, but the key point is that it is merely purchasing an option to purchase at five years. We've already established the full market value at \$600,000 that would be paid in the event the option to purchase is exercised.

Ms. Holmgren said the location of the high school was envisioned when we planned the development for Section 36 in the northwest corner. That section also houses a 60-acre commercial lease. We're in the process of negotiating with the Montana Department of Transportation for the Highway 93 bypass. Again, the location of the high school would be in the northwest corner of the Spring Prairie center. It is not a lease agreement, it is an easement with a five-year option. The school district can exercise that option within the five years, they don't have to wait five years in order to exercise it.

Joe McCracken, Flathead High School District #5, said this has been a little over a two-year process. Our district had quite a research project in looking at several different pieces of land, this one looks like the best piece for our second high school, and so it was chosen. We've come a long way since we began a couple of years ago. In February the School Board voted to look at it more closely and they voted Monday night to set the dollar amount for the bond that will be brought before the voters in November. We're moving forward on this. Even though we talk about a five-year option, the intent is that once the bond is passed, it will be paid for. We won't hold off for the next five years because the dollar amount is actually part of the bond that is going to be asked to be approved. He urged approval.

Mr. Clinch said it is \$6,000 annually for the option, and the total purchase price is \$600,000.

Mr. Brown said if the bond issue passes before the five years, they are not under any obligation to continue paying for \$6,000 for five years. Correct?

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Mr. Clinch said absolutely. That is what Mr. McCracken said, the intent is to pay that off as soon as possible. The five years just gives them a period of time in the event it is unsuccessful initially.

Motion was made by Mr. Brown to approve the easement request from Flathead School District #5. Seconded by Ms. McCulloch. Motion carried unanimously.

704-8 DISCUSSION OF COURT DECISION ON PREFERENCE RIGHTS

Attorney General McGrath requested this item be on the agenda. Mr. Clinch asked Mr. McGrath how would you like to proceed?

Mr. McGrath said it would be good for Tom Butler to give us a brief description. I think initially there was a reaction that may have overstated the nature of the case. It seems to me that the holding is fairly limited. Essentially what it says is that there is no absolute right of preference, that the Board has to make the decision if in fact we get into a situation where you get a current lessee who wants to retain his bid and is willing to match the bid. But maybe we should get a presentation from Tom first.

Tommy Butler, DNRC, said everyone has had a chance to review Judge Sherlock's decision which reviewed the constitutionality of procedures for issuing grazing leases on state school trust lands. Briefly, I would like to go over the facts. Previously, Mr. Harlow was the incumbent lessee, he was paying a grazing rental rate of \$5.77/AUM. Mr. Broadbent was the high bidder, he bid \$23.00/AUM. Subsequently, pursuant to §77-6-205, MCA, we went through the process of recognizing that Mr. Harlow had met the high bid, and under the statute he was entitled to retain the lease. He subsequently asserted that the \$23.00/AUM amount was excessive, and he petitioned the Board to reduce that down to the prevailing community standard. The Board agreed with the director to set that rate at the county competitive bid rate of \$10.52/AUM. Judge Sherlock, in reviewing the constitutionality of the statute, looked at the state's arguments. Basically, our department view was that the Board acted in the best financial interest of the lessee and that merely a right to meet the high bid does not cause a harm to the trust beneficiaries. That is on the basis of Montana Supreme Court's holding in Rider v. Cooney; the legislature gets to set procedures and the Land Board gets to constitutionally set the fair market value rate, for any interest in school trust lands. Also, in the MonTRUST action, the Montana Supreme Court recently stated, with respect to cabinsite leases, that competitive bidding is not necessarily required in all instances. In that instance, they were reviewing cabinsites. We also argued that the Board is constitutionally entitled to reduce the rate from \$23.00 to \$10.52 because the Board can reasonably adjust those rates to prevent physical impacts to the land so as to keep these leases and the lease rates ecologically and economically sustainable. The court looked at Thompson v. Babcock, which is the case we've often cited for the ability of the Board to adjust rental rates to the prevailing community standard. Thompson v. Babcock was a case pre-dating §77-6-205, MCA, and the court expansively interpreted the Board's duty to preserve the productivity of the leases and held that §77-6-205(1), MCA, the preference right, impermissibly interfered with the Board's discretion to preserve the corpus of the trust and the productivity of these easements. Procedure can generally be set by the legislature. However, the legislature cannot impermissibly intrude upon the Board's constitutional ability to capture full market value for trust beneficiaries. That's the interplay that we're looking at here: has the legislature impermissibly intruded upon the Board's discretion to manage the lands and get full market value? Currently, there has been no Notice of Entry of Judgment, the Judge has issued his opinion, he did not award his attorney's fees to Mr. Broadbent, but we haven't had the Notice of Entry of Judgment that starts

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the clock running on the time to appeal. If the Notice of Entry of Judgment were given today, we'd have 60 days to appeal, until the middle or end of September.

Mr. McGrath said I assume that you concur that the Judge did not require that each bid be awarded to the highest bidder.

Mr. Butler no, he did not. He didn't spend a great deal of time talking about the prevailing community standard. But I would assume that since he was striking down those provisions relating to the preference right, that the concept of the prevailing community standard still stands.

Mr. McGrath said on page 14 in the copy I have, he does indicate that the highest bid rate is only half of the equation, obtaining a lessee who will utilize the best management techniques is another measure of the legitimate advantage to the beneficiaries. In effect what he is saying is the Board has to, when these situations occur, make a determination as to who would best preserve the land for the beneficiaries.

Mr. Butler said yes, and that is obviously within the Board's discretion to choose the best lessee. Statutorily that was done under §77-6-205(1), MCA, and under the belief that the prevailing lessee, if you look at the Supreme Court's statement in Jerke and other cases, they talk about preference right as encouraging long term lessees with security of tenure to place improvements upon the lease and manage it on a long term basis.

Mr. McGrath said the Board can still determine to do that on a case-by-case basis.

Mr. Butler said yes. We have two choices here for the Board. Obviously, if you appeal and take that case on up, you need to apply first for a stay. If the Board decides not to appeal, we need to revise the statutory procedure in the statute and adopt administrative rules to be consistent with the decision. That would largely entail setting up a procedure for bidding, establishing the community standard, selecting the best lessee, and setting up criteria for that.

Mr. McGrath said isn't there a third option? We could go to the legislature and get the statute changed.

Mr. Butler said yes.

Mr. Morrison said I think the opinion is interesting and Sherlock's discussion of the dual role of the Land Board, not to just generate revenue but also to exercise other kinds of traditional trustee discretion. But the rule in the case, or the rule in the opinion, boiled down to adjustments, I think, the language on page 13, lines 20 – 22, in which he says the statute needed to apply, create situations where the Land Board has to accept the incumbent lessee as long as he/she has complied with the prior lease terms and meets the high bid rate. So the ruling is quite narrow. It simply says that §77-6-205, MCA, is unconstitutional because it takes discretion away from the Board. And I think that it would be pretty simple to rectify the problem with an amendment to the statute which essentially would say that the incumbent lessee can exercise his preference by meeting the high bid subject to the approval of the Board in its discretion as trustee.

Mr. McGrath said all of these are issues that we do have some time to address. There has not been an Entry of Judgment?

Mr. Butler replied no, not to date.

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Mr. McGrath said I just wanted to have this item on the agenda so we could discuss what the impact of the ruling is. As Tom said, we've got time. It is not an action item today.

Mr. Morrison said it might be worth having the department develop some suggested language for us to look at next month in terms of the bill.

Governor Martz said let's have the department bring this back to the Board with a recommendation. If it is an amendment on the bill, to change it and to recommend to us to take action. We can have a discussion with the department as we move along.

Mr. Clinch said that is an appropriate avenue. We need to have a continued discussion between now and the next Board meeting. If we are able to put things together, we very well may have something to come back to the next meeting to discuss.

Ms. McCulloch said if you remember just before we went to court we were discussing some of the grazing issues. I had asked DNRC to do a study of grazing issues because it was apparent from discussions before the lawsuit, and I realize the study was put on hold because of that suit, that there is still a lot of discrepancy between getting fair market value and money for the schools and making sure we're looking at the long term health of not just the grazing lands, but all the 5.2 million acres we have in state government that benefit our schools. I'd still like this broad discussion of this study to be still on the table even if we are looking at drafting recommended suggested language. I want the whole issue to be on the table. I still think there are issues that come before the Board dealing with grazing that aren't necessarily addressed in the Sherlock decision, but we still need to make sure we're conscious of them and can go forth on that.

Mr. Clinch said as we proceed along with this issue, we may very well become aware of what the next thing we need to do. That is what Ms. McCulloch is saying, that there might be other things to continue the discussion with.

Mr. Morrison said to make it clear, there was some panic and perhaps some misunderstanding after the story was initially reported in the paper, and an important thing for folks to realize is that Judge Sherlock did not say that the preference right is unconstitutional. Judge Sherlock simply said that the statute as presently worded does not permit the Board to exercise its constitutionally-vested discretion in the course of evaluating the preference right. So, the election of the preference right is unconstitutional. People should not be under the impression that Judge Sherlock said the preference right per se is unconstitutional.

Mr. Butler said I think there is a fine distinction here, and that is we had the intersection between two constitutional bodies, the legislature and the Land Board. The Land Board has constitutional discretion over the leasing of all school trust lands and control of the disposition of interests in school trust lands under Article X, Section 4. What the Judge is saying in my viewpoint is that the legislature cannot dictate to the Board this particular procedure because it impermissibly intrudes upon the discretion of the Land Board. The question is, is that statute constitutional? We think we made a good argument based upon existing case law from the Montana Supreme Court that the statute was indeed constitutional because it couldn't harm the financial interests of the trust beneficiaries. But you are correct, Mr. Morrison, that the Land Board itself as a constitutional body could choose to incorporate that very same preference right in the Board's policies.

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Mr. Morrison said I think we still have to exercise discretion on a case-by-case basis. But the point is, the preference right subject to our exercising our discretion on a case-by-case basis is not necessarily unconstitutional under Sherlock's ruling.

Mr. McGrath said I think that the point is that it is not an automatic decision. Right now under the process, if the current lessee meets the bid of a competing bidder, the current lessee automatically is entitled to a new lease. That is the issue. That has to be determined on a case-by-case basis.

Mr. Butler said that is a fair evaluation.

PUBLIC COMMENT
None at this meeting.

Motion was made by Mr. Brown to adjourn. Seconded by Ms. McCulloch.